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Supreme Court of the United States

October term, A. D. 1936.

No. 271

In the matter of 620 CHURCH STREET BUILDING CORPORATION, a corporation, debtor under section 77B of the bankruptcy act.

620 CHURCH STREET BUILDING CORPORATION, IRENE K. GOODMAN, G. WALLER, M. LONG, A. W. KIBBY, EMIL ROSENTHAL AND B. K. GOODMAN,

petitioners,

vs.

WARNER G. BAIRD, trustee of debtor, CHESTER R. DAVIS, MURRAY WOLBACH AND JAMES R. MCCAHEY, as members of bondholders committee for the holders of first mortgage bonds, LOUIS M. QUITMAN AND EDGAR N. GREENEBAUM, as trustees under first mortgage, WILLIAM L. O'CONNELL, as receiver of Central Republic Trust Company, CLARA ABT, LUCILLE ABT, EDWARD SCHOEN AND ALICE G. HIRSH,

respondents.

On writ of certiorari to the Circuit Court of Appeals for the Seventh Circuit.

Brief for the respondents Louis M. Quitman and Edgar N. Greenebaum, first mortgage trustees.

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respondents.

Brief for the respondents Louis M. Quitman and Edgar N. Greenebaum, first mortgage trustees.

STATEMENT OF THE CASE.

Grant of certiorari:

The order granting certiorari in this case (October 12, 1936) provided that the case be advanced for hearing immediately following no. 48, *Tennessee Publishing Company* v. *American National Bank, et al.* (R. 29.)

Errors assigned by petitioners:

Petitioners do not question the regularity or propriety of any of the proceedings and orders in this case prior to the entry of the order of March 31, 1936, confirming the plan of reorganization. Thus it is undisputed (1) that the debtor's voluntary petition for reorganization under section 77B of the bankruptcy act was properly filed under the statute, in good faith (R. 12—par. 1); (2) that the court acquired jurisdiction in this proceeding of the debtor and its property, all its creditors and stockholders (R. 12—par. 1); (3) that possession of the debtor's property—two leasehold estates and the improvements thereon, comprising the "Carlson Building Annex," in Evanston, Illinois—was in the hands of the trustee appointed in this proceeding (R. 7—par. 5); (4) that the petitioners, other than the debtor corporation, came into the proceeding to obtain allowance of their respective claims, to-wit, some as class 3 claims (on second mortgage notes), some as class 4 (on third mortgage notes), some as class 5 claims (stockholders) (R. 7—par. 4; R. 13—par. 3).

The errors assigned by petitioners (R. 18-20) are directed to the following findings and orders embraced in the confirmation decree:

> "5. That the committee acting under the deposit agreement dated December 12, 1929, referred to above, is lawfully constituted, and that the said committee has full power, right and authority to consent to and accept the plan for and on behalf of each of the holders of Carlson Annex bonds deposited with said committee under said deposit agreement; that the committee has accepted the plan in writing on behalf of the holders of all Carlson Annex bonds on deposit with it under said deposit agreement, to-wit: on behalf of the holders of $371,300 principal amount of said bonds with interest thereon, which amount is in excess of 66-2/3% of the aggregate amount of allowed claims of class 2, and such consent and acceptance so filed by the committee is hereby declared to constitute

the consent and acceptance of the plan by the holders of the certificates of deposit issued under said deposit agreement in respect of said Carlson Annex bonds on deposit with the committee thereunder." (R. 14.)

"11. That the court having heard evidence and testimony on the value of the property of the debtor finds: that the principal property of the debtor consists of the two leasehold estates and improvements on the property located at 620 to 628 Church Street, in the City of Evanston, County of Cook, and State of Illinois, said two leasehold estates, together with all improvements thereon and appurtenances thereto, being more specifically described in the plan and being hereinafter sometimes referred to as the 'Carlson Building Annex'; that the Carlson Building Annex has a fair market value of $245,025, and that there is no equity over and above the $445,500 principal amount of Carlson Annex bonds outstanding against the Carlson Building Annex; that the debtor is accordingly insolvent; that the stockholders are not entitled to participate in the plan, and that their acceptance of the plan is not a prerequisite to the confirmation of the plan." (R. 15.)

"12. That based on the abovementioned evidence and testimony concerning the value of the Carlson Building Annex, the court has appraised and does hereby appraise all claims allowed in class 3 and class 4 to be of no value, there being no equity in the Carlson Building Annex bonds outstanding against the Carlson Building Annex, and accordingly no securities, cash or any other thing of value shall be distributed under the plan in respect of any of the claims allowed in classes 3 and 4, and the acceptance of the plan by the holders of such claims is not a prerequisite to the confirmation of the plan. The court further finds that the foregoing method of treatment of the holders of claims in classes 3 and 4 provides adequate protection for the realization by the holders thereof of the value thereof under and consistent with the circumstances of the case, the same being of no value." (R. 15.)

"13. That the plan has been accepted as required by the provisions of subdivision (e) of section 77B of the Act to Establish a Uniform System of Bankruptcy throughout the United States as amended (hereinafter referred to as the 'Bankruptcy Act'), and the above described acceptances have been filed in this proceeding." (R. 15.)

"15. That the plan is fair, equitable, and feasible, and does not discriminate unfairly in favor of any class or classes of creditors or stockholders." (R. 16.)

"20. That all provisions of the bankruptcy act which ought to be complied with prior to the confirmation of the plan have been fully complied with in the manner provided therein." (R. 16.)

"21. That all objections to the plan, oral or written, are hereby overruled, and the plan is hereby in all respects finally approved and confirmed." (R. 16.)

"22. That the provisions of the plan and of this order shall be binding upon the debtor, all of its stockholders, including those who have not as well as those who have accepted the plan, and all creditors of the debtor, secured or unsecured, whether or not affected by the plan, and whether or not their claims have been filed, and if filed whether or not allowed, including creditors who have not as well as those who have accepted the plan." (R. 16.)

The errors assigned by petitioners, though seventeen in number (R. 18-20), present only two distinct propositions:

(1) That the district court erred in finding that the fair market value of debtor's property is $245,025; and that consequently (a) there is no equity over the principal amount of the outstanding first mortgage bonds ($445,500);* (b) the debtor is insol-

*The first mortgage indebtedness includes interest from January 1, 1931; at 6% to date of confirmation decree—ignoring the 7% rate applicable after default—equals $144,332.50. This brings the total to $585,832.50, without taking account of the expenses of litigation and other accrued charges under the first mortgage.

vent; (c) the class 3 and class 4 claims are valueless.

(2) That, notwithstanding these circumstances, the district court erred in decreeing that junior claimants were not equitably entitled to apportionment of any cash or securities under the plan of reorganization and their consent was not a prerequisite to confirmation of the reorganization plan.

Value of property and claims:

The Circuit Court of Appeals, in its memorandum on the petition for appeal, said (R. 21):

> "In view of the fact that, upon what must have been a full hearing as to value of the premises, the court made a specific finding as to that value, this court would have no right to disturb that finding."

We remind the court that the petition for leave to appeal from the decree of the district court was filed under section 24(b) of the bankruptcy act, pursuant to which the Circuit Court of Appeals could exercise jurisdiction only "to superintend and revise in matter of law." No claim is made by any assignment of error that the petitioners were denied a fair and adequate hearing as to the value of debtor's property and of petitioners' claims. No question of law is raised with respect to any incident of this hearing.

Confirmation of plan without petitioners' consents:

Thus the case narrows down to a single point. Value or no value, is the consent of junior claimants of various classes an indispensable prerequisite to confirmation of a plan of reorganization by a court of bankruptcy, exercising jurisdiction under section 77B of the bankruptcy act, when after a fair hearing it has been determined that such claims are valueless? Or, lacking such consents, must the court reject reorganization for the benefit of senior lienors and abandon its jurisdiction (so that, as petitioners assume,

the first mortgage bondholders will be compelled to resort to a foreclosure sale under state law, with attendant rights of redemption)?

Contentions of respondents:

(1) The benefits of a reorganization plan under section 77B need not extend to all classes of creditors and stockholders, if the liabilities of the debtor corporation exceed its assets, but only to those equitably entitled to participate, according to the amount, quality and priority of their respective claims.

(2) Subsection (b) of section 77B*—more particularly, subparagraph (4) and subparagraph (5) (c) and (d) of subsection (b)—as applied in this case, does not deprive petitioners of property without due process of law.

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*Quoted in Appendix, p. 22.

SUMMARY OF ARGUMENT.

I.

Since an appeal under section 24(b) of the bankruptcy act is confined to questions of law, the Circuit Court of Appeals properly held (R. 21) that—with no challenge to the fairness or adequacy of the hearing as to the value of debtor's property and petitioners' claims—the correctness of the valuation arrived at by the district court is not reviewable.

In re Loving, 224 U. S., 183, 188-189, 56 L. ed. 725, 726-727.

Elliott v. Toeppner, 187 U. S. 327, 334, 47 L. ed. 200, 203.

II.

Reorganization under section 77B of the bankruptcy act is not limited—either (a) by statutory formula, or (b) by demands of equity, or (c) by constitutional mandate—to a plan extending participation to all classes of creditors and stockholders, when the liabilities of the debtor corporation exceed its assets.

Section 77B of the bankruptcy act, subsection (b)—(1), (2), (4), (5), (9); also subsection (e) (1) (11 U.S.C. section 207, subsections as above).*

In re Central Funding Corp. (CCA 2), 75 F. (2d) 256, 259-260.

In re Mortgage Securities Corp. (CCA 2), 75 F. (2d) 261.

In re Reading Hotel Corp. (D.C., E.D. Pa.), 10 F. Supp. 470.

In re William Penn Garage (D. C., W. D. Pa.), Commerce Clearing House Bankruptcy Law Service, ¶3649.

See also cases cited under Points III, IV and V, *infra.*

*Quoted in Appendix, pp. 22-24.

III.

Exercise of bankruptcy jurisdiction in a manner that disposes of the property of the bankrupt (or "debtor" under section 77B) without foreclosure sale and attendant rights of redemption under state law, does not violate the due process provision of the fifth amendment.

Van Huffel v. Harkelrode, 284 U. S. 225, 227-228, 76 L. ed. 256, 259 (sale in bankruptcy free and clear of liens, under Act of 1898).

Ray v. Norseworthy, 23 Wall. (90 U. S.) 128, 23 L. ed. 116 (sale in bankruptcy free and clear of liens, under Act of 1867).

Houston v. City Bank of New Orleans, 6 How. (47 U. S.) 486, 506, 12 L. ed. 526, 534 (sale in bankruptcy free and clear of liens, under Act of 1841).

Dugan v. Logan, 229 Ky. 5, 16 S. W. (2d) 763; cert. den. 280 U. S. 587.

American Mines Equipment Co. v. Illinois Coal Corp. (CCA 7), 31 F. (2d) 507, 510-513; cert. den. 280 U. S. 572, 74 L. ed. 624 (sale by federal court without right of redemption, under general creditors' bill filed with debtor's consent).

In re Novak (D.C., N.D. Ia.), 111 Fed. 978 (no right of redemption from trustee's sale in bankruptcy).

Brown v. Timmons, 79 Mont. 246, 256 Pac. 176, 178-179 (bankrupt's right of redemption from foreclosure sale by state court passed to trustee in bankruptcy).

In re Central Funding Corp. (CCA 2), 75 F. (2d) 256, 260-261.

In re New York, New Haven & Hartford Rd. Co. (D. C. Conn.—Sept. 15, 1936), Commerce Clearing House Bankruptcy Law Service, ¶4172.

IV.

Although it is stated in the opinion of this court in Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, that "by the settled practice, a sale free of liens will not be ordered by the bankruptcy court if it appears that the amount of the incumbrance exceeds the value of the property," this refers to ordinary bankruptcy liquidation proceedings and not to reorganization proceedings under section 77B; and moreover, does not deny the power of a bankruptcy court, under appropriate circumstances, to order such sale regardless of the value of the property.

In re Franklin Brewing Co. (CCA 2), 249 Fed. 333, 335.

In re Union Trust Co. (CCA 1), 122 Fed. 937, 939, 940.

In re Roger Brown & Co. (CCA 8), 196 Fed. 758, 761.

In re Throckmorton (CCA 6), 196 Fed. 656, 659.

In re Hasie (D.C. Tex.), 206 Fed. 789, 792.

In re Theiberg (D.C., N.J.), 280 Fed. 408.

In re Loveland (CCA 1), 155 Fed. 838, 839.

In re Central Funding Corp. (CCA 2), 75 F. (2d) 256, 260-261.

V.

It is no longer open to dispute that the power of Congress to legislate on the subject of bankruptcies includes the power to bring within the bankruptcy jurisdiction the subject of corporate reorganizations. Such jurisdiction is not rendered unconstitutional because it extends to secured claims against the debtor and its property as well as unsecured claims; nor because it provides remedies for the ascertainment and enforcement of pre-existing lien claims other than those provided by state law—remedies affording substantially equivalent benefits.

Continental Illinois National Bank & Trust Co. v. C. R. I. & P. Ry. Co., 294 U. S. 648, 667-675, 79 L. ed. 1110, 1123-1127.

Campbell v. Allegheny Corp. (CCA 4), 75 F. (2d) 947, 951-955; cert. den. 296 U. S. 581, 80 L. ed. 104.

In re Landquist (CCA 7), 70 F. (2d) 929, 933; cert. den. 293 U. S. 584, 79 L. ed. 680.

Hanover National Bank v. Moyses, 186 U. S. 181, 46 L. ed. 1113.

Ex parte City Bank of New Orleans, 3 How. (44 U. S.) 292, 316, 11 L. ed. 603, 614.

Nugent, Assignee, v. Boyd, 3 How. (44 U. S.) 426, 437, 11 L. ed. 664, 669.

McRaney v. Riley, 128 Miss. 665, 91 So. 399, 400-402.

In re Jersey Island Packing Co. (CCA 9), 136 Fed. 625, 627.

In re New York, New Haven & Hartford Rd. Co. (D.C. Conn.), Commerce Clearing House Bankruptcy Law Service, ¶4172, at pp. 2161-2162.

ARGUMENT.

The correctness of the trial judge's valuation of debtor's property and of petitioners' claims is not reviewable.

Petitioners, in conformity with section 24(b) of the bankruptcy act, petitioned the Circuit Court of Appeals "that they may be allowed, in the discretion of this honorable court, to appeal in matter of law herein." (R. 9.)

The scope of such appeal, if granted, is strictly limited to questions of law (*In re Loving,* 224 U. S. 183, 188-189; *Elliott* v. *Toeppner,* 187 U. S. 327, 334.)

With no challenge to the fairness of the hearing on the value of debtor's property and of petitioners' claims, no contention that incompetent evidence was received or competent evidence excluded, the Circuit Court of Appeals correctly concluded that it would have no right to disturb the trial judge's finding of value. (Memorandum denying appeal, *supra,* p. 5.)

II.

Reorganization under Section 77B need not extend participation to all classes of creditors and stockholders, when liabilities of debtor corporation exceed assets.

The text of the statute, quoted at pp. 22-24 *infra,* leaves no doubt of the intention to provide for a reorganization such as that accomplished in this case, namely: a transfer of the Carlson Annex leaseholds, held by the 620 Church Street Building Corporation, to the 636 Church Street Building Corporation, holder of the adjoining Carlson Building leasehold, and issuance to the holders of Carlson Annex bonds of (a) $222,850 new first mortgage bonds out of $684,750 to be secured by the combined leaseholds, also (b) 25% of the common stock of the new owner corporation.* A complementary plan of reorganization of the 636

*The new bonds allocated to the Carlson Annex bondholders represents 50% of the face amount of their old bonds; the stock, one share per $500 old bond.

Church Street Building Corporation was consummated in another section 77B proceeding in the same court. (R. 7-8, par. 9.)*

No question is raised as to the regularity of the proceedings in this case up to the point of entry of the decree confirming the plan of reorganization. At this stage of the proceedings—in a case where the fair market value of the debtor property is but 40% of the first mortgage indebtedness—challenge comes only from claimants whose interest in the debtor's property are indisputably inferior to the interest of the first mortgage bondholders.

Manifestly, if under the circumstances of this case a reorganization under section 77B could not apportion all of the debtor's property to the senior claimants, in accordance with elementary precepts of equity, the statute would be of no avail in this case and many similar cases. Instead, the "nuisance values" and "maneuvering values" by means of which unjust toll was commonly exacted as part of the price of corporate reorganization through equity receivership proceedings, or kindred proceedings, would continue to thrive.

As stated by Circuit Court of Appeals for the Second Circuit, in upholding a reorganization under section 77B for the benefit of first mortgage bondholders only, where essentially all that was accomplished was to defer liquidation of the collateral securing the first mortgage bonds (*In re Central Funding Corp.*, 75 F. (2d) 256):

> "The most flagrant occasion for a reorganization is where only creditors' rights are to be adjusted, and liquidation is to be slow enough to take advantage of market conditions obtaining over a long period. Section 77B expressly provides for such situations as we

*The Carlson Building is a 9-story office and store building at the southeast corner of Orrington avenue and Church street, Evanston, Illinois. The Carlson Annex is a part 7-story and part 2-story office and store building adjoining the corner building to the east of Church street. The Annex has no independent heating plant, elevators, or entrance lobby, but avails itself (under operating contract) of these facilities of the corner building.

have here, and they are proper subjects of bankruptcy legislation. To restrict the Act to reorganizations where the debtor has an equity would be to deprive the section of much, if not most, of its usefulness." (p. 261.)

"We cannot, however, doubt that it is within the general meaning of the term 'reorganization'. In common parlance that term is not limited to cases where the rights of all persons interested in a corporation, whether lienors, general creditors or stockholders, are made to survive under some new corporate arrangement. Not infrequently the rights of some of these classes have become so worthless that they deserve and receive no recognition in the reorganization." (p. 259.)

Under paragraph (4) of subsection (b) of section 77B, if the judge determines that the debtor is insolvent, no provision need be made in the plan of reorganization for stockholders. Under paragraph (5) of subsection (b), if two-thirds of any class of creditors do not accept the plan, the plan must provide "adequate protection" for the realization of the value of the interest, claim, or lien of such class in debtor's property, through (a) continued subjection of the property to such interest or lien, or (b) sale free of such interest or lien at fair upset price, or (c) appraisal of such interest or lien and payment of appraised value in cash, or (d) by such method as, in the opinion of the judge, under the circumstances of the particular case, will equitably provide such "adequate protection."*

The court's finding of insolvency obviated any need to make provision, under the plan confirmed in this case, to protect the interest of stockholders. "Adequate protection" of the interests, claims and liens of the second and third mortgage noteholders was afforded under the plan by providing for appraisal of the value of these claims, such value to be paid in cash.

*Text of statute, *infra*, p. 22.

Naturally, with first mortgage indebtedness two and one-half times the value of debtor's property, it was undoubtedly anticipated by the proponents of the plan that appraisal would yield no cash to the junior creditors. But if the "adequate protection" afforded by the plan yielded nothing to the second and third mortgage noteholders, this result was caused not by the plan, nor by the court's decree, nor by the enactment of section 77B, but by misjudgment in the original investment represented by these junior claims, or if the original investment was sound to subsequent retrogression due to the turn of economic events. If, in the apportionment of assets consistent with equitable priorities, a court of bankruptcy turns away some claimants empty-handed, this is not a deprivation of property without due process of law. Rather, it is of the essence of bankruptcy process, of which one of the main objectives —formerly the sole objective—is the distribution of the debtor's assets to its creditors in measure with the quality and quantity of their claims.

We quote from the opinion of the Circuit Court of Appeals for the Fourth Circuit in *Campbell* v. *Allegheny Corporation*, 75 F. (2d) 947, at pp. 953-954:

> "Little need be said as to the question which arises under the fifth amendment. There is no question, of course, but that the exercise of the bankruptcy power by Congress, as is the case with other delegated powers, is subject to the requirement of due process contained in that amendment. *Monogahela Nav. Co.* v. *U. S.*, 148 U. S. 312, 336, 13 S. Ct. 622, 37 L. Ed. 463; *Hanover Nat. Bank* v. *Moyses, supra*, 186 U. S. 181, 192, 22 St. Ct. 857, 862, 46 L. Ed. 1113. But as any exercise of the bankruptcy power impairs the obligation of contracts, such impairment is not to be taken as in itself a denial of due process. For the provisions of the act to violate the amendment, they must be so grossly arbitrary and unreasonable as to be incompatible with fundamental law. *Hanover Nat. Bank* v. *Moyses, supra.* We do not think that the requirement

that secured creditors scale their debts in accordance with a plan which two-thirds of them are willing to accept and which has been approved by the court as reasonable and fair, and accept in lieu of payment in money such securities as are specified in the plan, can be said to be such an arbitrary and unreasonable exercise of the bankruptcy power as to amount to a denial of due process.

The fact that secured debts are affected by the act does not, of course, raise any grave constitutional question, and can be dismissed with brief comment. "A secured debt or lien is, so far as the Constitution of the United States is concerned, a no more sacred kind of property than an unsecured debt. * * * And the Constitution expressly permits and grants to Congress the exercise of the power to affect such property, whether it be an unsecured debt or whether it be a lien, by laws relating to 'subject of bankruptcies.'" In re Burgh (D. C.), 7 F. Supp. 184, 185.

As a matter of fact, no property in any real sense is taken from the dissenting creditor when he is compelled under section 77B to scale his claim and accept securities in lieu thereof. The securities held by him have already shrunk in value before the proceeding under the act is instituted; and all that is required of him is that he face reality and accept his pro rata interest in the debtor's property in a form which will not jeopardize the rights of other creditors similarly situated. If he were allowed to insist on the foreclosure of the lien in which he is interested in common with others, he would bring serious injury to them without benefit to himself. Under the act, he is merely required to accept what two-thirds of those similarly situated are willing to accept, and what the court has found to be fair and reasonable under the circumstances; and, when the situation is viewed realistically, it is readily seen that he is not required to surrender any part of the value either of his securities or of the property available for the payment of his claim. What he in fact gives up is merely the arbitrary power to frustrate the wishes of the great majority of those who have a common interest in the property of the debtor, or, in other words, the power to demand from other creditors an

unconscionable settlement of his claim as the price of withdrawing objection to a plan of reorganization which is fair to all parties concerned.

The act is based upon an equitable recognition of the rights of all who have an interest in a common property, and is in accord with the principle under which courts of equity have denied to dissenting creditors the right to prevent the consummation of a plan of reorganization which has been found to be fair and open to all creditors on the same terms. See *Fearon* v. *Bankers' Trust Co.* (C. C. A. 3), 238 F. 83; *Simon* v. *New Orleans R. Co.* (C. C. A. 5), 242 F. 62. It embodies substantially the principles of corporate reorganization adopted in England and Canada many years ago, and, as shown above, held reasonable by the Supreme Court in the case of *Canadian Southern Ry. Co.* v. *Gebhard, supra,* where the court said: 'In no just sense do such governmental regulations deprive a person of his property without due process of law.' "

In the reorganization of the Reading Hotel Corporation under section 77B, approved by the District Court for the Eastern District of Pennsylvania (10 F. Supp. 470), the master found the debtor "definitely and hopelessly insolvent." The stockholders, on exceptions to the master's report, contended that the master erred in failing to take account of "a potential value which is really based upon a guess (perhaps not altogether unjustified) that the hotel by reason of past history of wide advertisement, good management, and excellent reputation will, when times improve, make money for its then owners." The court held, however, that there was nothing in section 77B which justified such an interpretation of the statute, or changed the original definition of insolvency. To the argument of the stockholders that section 77B was passed for the relief of debtors, and that unless some recognition were given to the interests of stockholders a reorganization under section 77B in the case of an insolvent corporation with a mortgage indebtedness would amount to nothing more than foreclos-

ure with possible readjustment of interests among various classes of creditors, the court responded (p. 471):

> "The insolvency of the debtor corporation eliminates the necessity for acceptance by a majority of stockholders as a prerequisite to the confirmation of the plan. It also eliminates the necessity of making provision for dissenting stockholders in the plan. But when subsection (b) (4) speaks of providing for stockholders, the provision it refers to is 'adequate protection for the realization by them of the value of their equity.' Obviously, if there is no equity, there is nothing which can be 'realized,' and the stockholders are not entitled to any of the alternatives such as sale of the property or cash payments, which they would have if their holdings had a present cash value."

III and IV.

Bankruptcy distribution of debtor's property without foreclosure sale and rights of redemption does not violate the due process provision of the fifth amendment.

The petition for certiorari in this case stresses mainly the rights of junior lienors: the right to insist upon a public sale, the right to bid at such sale, the right of redemption within fifteen months. (Petition, p. 28.) Of the right to redeem, petitioners say: "Whether valuable or not from a monetary standpoint, however, it is absolute and vested and it is not for the court to put a price upon it or to declare it valueless." (Petition, p. 33.)

It is by no means a self-evident postulate, as assumed by petitioners, that in default of reorganization under section 77B the debtor's property would be disposed of by foreclosure sale, and that some of the petitioners would thereupon become vested with the right to redeem from such sale within fifteen months. Other methods of liquidation of the debtor's property, without rights of redemption, are illustrated by the cases cited at pp. 8-9, *supra* (under points III and IV). These methods include sale in bank-

ruptcy liquidation free and clear of liens; sale free of redemption rights in a federal equity receivership proceeding; sale free of redemption rights in equivalent state court corporate liquidation proceedings.

In neither the 1841, 1867 or 1898 bankruptcy acts do we find any express grant of power to courts of bankruptcy to sell mortgaged property free and clear of liens; in each of these acts, at the same time, we find (in varying form) an express declaration that valid mortgages and liens on the debtor's property shall not be affected, if not fraudulent or preferential; yet under each of these acts the power to sell the debtor's property free and clear of liens has been recognized as implicit in the general grant to the courts of bankruptcy of all equitable powers essential to the proper administration and distribution of insolvent estates. Under the act of 1841: *Ex parte The City Bank of New Orleans,* 3 How. 292, 11 L. ed. 603; *Nugent, Assignee,* v. *Boyd,* 3 How. 426, 11 L. ed. 664; *Houston* v. *City Bank of New Orleans,* 6 How. 504, 12 L. ed. 426. Under the act of 1867: *Ray* v. *Norseworthy,* 23 Wall. 128, 23 L. ed. 116. Under the act of 1898: *Van Huffel* v. *Harkelrode,* 284 U. S. 225, 76 L. ed. 256; *In re Union Trust Co.* (C. C. A. 1), 122 Fed. 937; additional cases cited under point IV, *supra,* p. 9.

While it may well be "the settled practice" in general bankruptcy not to sell property free and clear of liens unless it is fairly anticipated that the sale will produce a margin over the lien indebtedness, it has often been declared that this is a rule of policy, and not a delimitation upon bankruptcy jurisdiction. (See cases cited at p. 9, *supra,* under point IV.)

But even if it is assumed that the only alternative to reorganization under section 77B is reversion to the foreclosure suit suspended by the institution of this proceeding, and that a foreclosure sale of the debtor's leaseholds would vest in some of the petitioners the right to redeem, it is a distortion of the decision of this court in *Louisville Joint*

Stock Land Bank v. *Radford* to say that the bankruptcy power transgresses the due process of law, in contravention of the fifth amendment, when it produces such a result. It is the ordinary and inherent routine of bankruptcy jurisdiction to divest property rights. The difficulty encountered in the *Radford* case was not merely that the mortgagee was to recover less than its due from an insolvent debtor. The mortgaged farm was not to be sold or conveyed for the benefit of the mortgagee (and other creditors, if the proceeds of the sale exceeded the mortgage), but to be restored to the mortgagor on a rental basis for a span of five years, subject meanwhile to an option in the mortgagor to dispose of the mortgage indebtedness at less than half its amount.

The *Radford* case, with its forceful insistence that the mortgagor could not be thus indulged at the expense of the mortgagee, after default had ripened the mortgagee's right to satisfy its claim out of the mortgaged property, is strong authority against the contention of petitioners in this case. The rights of petitioners are not cut down by section 77B of the bankruptcy act, but fully recognized and preserved. All that happened, in consequence of debtor's resort to bankruptcy jurisdiction under section 77B, was a change of forum and procedure, but not interposition of a new measure of rights. It is elementary that bankruptcy may supplant any and all modes of procedure provided by state law for the enforcement of the obligations of a debtor in failing circumstances. "It is, in short, a system of laws to take care of the rights of the parties interested, when a business failure supervenes." (Remington on Bankruptcy, 4th ed. v. I, p. 47.)

V.

The power of Congress to legislate on the subject of bankruptcies may properly extend to secured claims against the debtor's property as well as unsecured claims; and may provide remedies for the ascertainment and enforcement of pre-existing lien claims other than those provided by state law, provided such remedies afford substantially equivalent benefits.

Petitioners do not question the general validity of section 77B as a code of procedure for the reorganization of financially embarrassed or insolvent corporations; nor that such reorganization may deal with claims secured by liens on the debtor's property as well as unsecured claims. The petitioner corporation itself initiated this proceeding for reorganization; the petitioners who hold second or third mortgage notes of the debtor corporation came into the proceeding to prove their claims—and, if possible, to persuade the first mortgage bondholders voluntarily to yield to them some share in the reorganization, despite the great disparity between the first mortgage indebtedness and the value of the debtor property. (R. 7—pars. 7 and 8.)

Because their claims were worthless *ab initio*, or have been rendered worthless by the course of events, the procedure provided by section 77B has brought petitioners no cash or substituted securities. Not by legislative or judicial fiat that they shall take less than their due, but by orderly and fair ascertainment of what is justly recoverable on their claims upon general distribution of the insolvent debtor's assets. Petitioners protest that, as the matter has turned out, they might be better off if the first mortgage bondholders were denied the facilities and economies of reorganization procedure under section 77B and remitted to foreclosure under state law. If so, it is not because of any showing that prolongation of the litigation for another year or more would increase the value of debtor's property from $245,025 to something over $600,000, the approximate first mortgage indebtedness at this time with-

out reckoning accrued and future costs of litigation. Reduced to its ultimate essence, the true complaint of petitioners is that section 77B, as applied in this case, has deprived them of such maneuvering advantages as they might have had under the inefficient and unduly costly modes of procedure for corporate reorganization which section 77B was designed to supplant. It would be anomalous, indeed, if equity or the constitutional requirement of due process could reasonably be found to support a contention so flagrantly at odds with justice and good conscience.

Not to elaborate upon what this court has said about the nature and scope of the bankruptcy power (cases cited at pp. 9-10, *supra*), we submit that this great and beneficent power conferred on Congress by the federal constitution has not been unconstitutionally exercised in the enactment of section 77B of the bankruptcy act, or any of the subdivisions thereof herein involved; that in the application of section 77B in this case no inequity has resulted to the petitioners, or any of them; that the first mortgage bondholders, through the reorganization confirmed by the court, will receive no more than their equitable due as the holders of obligations secured by superior lien on the debtor's property. Wherefore, these respondents urge that the Circuit Court of Appeals did not err in denying to petitioners leave to appeal, and that said order of the Circuit Court of Appeals and the decree of the District Court should be affirmed.

Respectfully submitted,

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APPENDIX.

Section 77B of Bankruptcy Act, 11 U. S. C. Section 207.

Subsection (b):

"A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character or otherwise; * * * (4) shall provide in respect of each class of stockholders, of which less than a majority shall accept such plan (unless the judge shall determine either that the debtor is insolvent, or that the interest of such class of stockholders will not be affected adversely by the plan), adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either, as provided in the plan, (a) by a sale of the property at not less than a fair upset price, or (b) by appraisal and payment in cash of the value either of their stock, or at the objecting stockholders' election, of the securities allotted to such stockholders under the plan, if any shall be so allotted, or (c) by such methods as will do substantial justice to such stockholders under and consistent with the circumstances of the particular case; (5) shall provide in respect of each class of creditors of which less than two thirds in amount shall accept such plan (unless the claims of such class of creditors will not be affected by the plan, or the plan makes provision for the payment of their claims in cash in full), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens is dealt with by the plan, either, as provided in the plan, (a) by the transfer or sale of such property subject to such interests, claims, or liens, or by the retention of such property by the

debtor subject to such interests, claims, or liens, or (b) by a sale free of such interests, claims, or liens at not less than a fair upset price and the transfer of such interests, claims, or liens to the proceeds of such sale; or (c) by appraisal and payment either in cash of the value either of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted; or (d) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection; * * * (9) shall provide adequate means for the execution of the plan, which may include the transfer of all or any part of the property of the debtor to another corporation or to other corporations, or the consolidation of the properties of the debtor with those of another corporation, or the merger or consolidation of the debtor into or with another corporation or corporations, or the retention of the property by the debtor, the distribution of assets among creditors or any class thereof, the satisfaction or modification of liens, indentures, or other similar instruments, the curing or waiver of defaults, extension of maturity dates of outstanding securities, the change in interest rates and other terms of such securities, the amendment of the charter of the debtor, and the issuance of securities of either the debtor or any such corporation or corporations, for cash, or in exchange for existing securities, or in satisfaction of claims or rights, or for other appropriate purposes."

Subsection (e):

"(1) A plan of reorganization shall not be confirmed until it has been accepted in writing, whether before or after the filing of the petition or answer under this section, and such acceptance shall have been filed in the proceeding by or on behalf of creditors holding two thirds in amount of the claims of each class whose claims have been allowed and would be affected by the plan and by or on behalf of stockholders of the debtor holding a majority of the stock of each class: *Provided, however,* that such acceptance shall not be requi-

site to the confirmation of the plan by any creditor or class of creditors (a) whose claims are not affected by the plan, or (b) if the plan makes provision for the payment of their claims in cash in full, or (c) if provision is made in the plan for the protection of the interests, claims, or liens of such creditor or class of creditors in the manner provided in subdivision (b), clause (5), of this section: *And provided further*, that such acceptance shall not be requisite to the confirmation of the plan by any stockholder or class of stockholders (1) if the judge shall have determined either that the debtor is insolvent, or that the interests of such stockholder or stockholders will not be affected by the plan, or (2) if provision is made in the plan for the protection of the interests of such stockholder or class of stockholders in the manner provided in subdivision (b), clause (4), of this section."

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 271

IN THE MATTER OF THE

620 CHURCH STREET BUILDING CORPORATION, A CORPORATION, DEBTOR UNDER SECTION 77B OF THE BANKRUPTCY ACT.

620 CHURCH STREET BUILDING CORPORATION, ET AL.,

Petitioners,

vs.

WARNER G. BAIRD, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petition for Rehearing.

THEODORE E. REIN,
ISAAC M. MILLS,
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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petition for Rehearing.

To the Honorable Justices of the Supreme Court of the United States:

Comes now Emil Rosenthal and B. K. Goodman, petitioners for certiorari, by their counsel, and present this, their petition for re-hearing, and in support thereof respectfully show:

I.

Introductory Statement.

This case deals with the right of a District Court to confirm a plan of reorganization without the consent of junior lienors which deprives them of their liens, their right to a public sale, their right to bid and their right of redemption under the Illinois Statutes, all without compensation.

The 620 Church Street Building Corporation (herein referred to as Debtor) filed its voluntary petition for reorganization under Section 77B of the Bankruptcy Act. Its principal property, consisting of a building constructed on leased ground, is subject to three trust deeds executed prior to the enactment of Section 77B and securing:

a.	First mortgage bonds	$445,500
b.	Second mortgage notes	40,250
c.	Third mortgage notes	27,000

The plan approved by the District Court provides that the property of the Debtor shall be conveyed to the 636 Church Street Building Corporation, a separate and independent corporation, in consideration of stocks and bonds to be divided solely among the holders of the first mortgage bonds of the Debtor.

II.

Jurisdiction.

The Court of Appeals for the Seventh Circuit, denied petitioners leave to appeal from the order confirming the plan. This Court allowed certiorari. After a hearing, the

Court rendered its opinion on November 9th, 1936, to the effect that the Court of Appeals did not abuse its discretion in declining to allow the appeal.

III.

Reasons for Petition for Rehearing.

The opinion of this Court is based on the assumption that the District Court found as a fact that all the rights of the petitioners are of no value. This Court held that petitioners, being bound by the finding of the District Court, could not raise the constitutional question, having no value to protect.

The fact is that the District Court did not consider all the rights of petitioners and made absolutely no finding as to the most important of them.

The District Court found that petitioners' claims on their notes are of no value but made no finding as to the value of the substantive property rights of petitioners under their mortgages and the Statutes of Illinois, particularly their right to redeem the property of the Debtor.

Had the District Court fully considered petitioners' rights under their mortgages and under the Illinois Statutes, it would not have entered the order of confirmation in this case which, unless set aside by this Court, will have a disastrous effect on the security of all real estate mortgages and introduce a new and dangerous doctrine in the law of mortgages—a doctrine which will upset long established principles of law which have given stability to mortgage securities for many generations—a doctrine which will not appreciably facilitate proceedings under Section 77B—a doctrine which asserts that a mortgagor, by filing a peti-

tion in bankruptcy, may change the terms of a mortgage and destroy vested rights created thereby and by the statutes existing at the time the mortgage was executed.

Petitioners earnestly beg this Court to consider the grave consequences of its decision not only out of regard for the rights of petitioners but in view of its effect on the law of mortgages.

To demonstrate that the District Court did not make the finding of fact which this Court assumed and on the binding effect of which this Court based its opinion, petitioners desire to clearly point out the errors made by the District Court, namely:

A. The District Court erred in viewing the rights of the petitioners as being limited solely to a claim on the notes held by them. It overlooked their vested substantive rights in specific property arising out of and existing by virtue of the trust deeds securing the notes, and the statutes of the State of Illinois.

B. Granting that the District Court did not overlook the property rights of petitioners under their mortgages and the Illinois Statutes, then it erred in drawing from the testimony as to, and its finding of, the fair market value of the property of the Debtor, the erroneous inference that the vested property rights of petitioners are of no value.

C. The District Court erred in not ascertaining the value of the security to petitioners' notes by the methods set forth in Section 57 (h) of the Bankruptcy Act.

D. The District Court erred in confirming a plan which provided for the conveyance of the Debtor's property for a consideration not measurable in money and thereby depriving petitioners of their vested substantive rights in the property contrary to the Fifth Amendment.

IV.

ARGUMENT.

A. The District Court erred in viewing the rights of petitioners as being limited solely to a claim on the notes held by them. It overlooked their vested substantive rights in specific property arising out of and existing by virtue of the mortgages securing the notes, and the statutes of the State of Illinois.

The District Court placed the notes of the petitioners in classes 3 and 4 (R. 13), using the following language:

> "Class 3: Those claims allowed in these proceedings against 620 Church Street Building Corporation or its property, with respect to the notes secured by trust deed dated July 13, 1928, from Carlson Annex Building Corporation to B. K. Goodman, as trustee."
>
> "Class 4: Those claims allowed in these proceedings against 620 Church Street Building Corporation or its property, with respect to the note secured by trust deed dated June 3, 1931, from 620 Church Street Building Corporation to W. Kahn, as trustee."

The express language used refers to claims on the notes. The remaining words are descriptive of the notes and identify them.

Paragraph 12 of the order of confirmation (R. 15) covers the so-called appraisal of the above claims. The language, so far as applicable, is as follows:

> "That based on the above mentioned evidence and testimony *concerning the value of the Carlson Build-*

ing Annex, the Court has appraised and does hereby appraise all claims allowed in Classes 3 and 4 to be of no value * * *"

Here, too, the reference is definitely to the claims on the notes.

It is hardly necessary to point out to this Court that when notes are issued and secured by a mortgage on real estate, various rights come into existence. The notes evidence a personal obligation of the maker to pay the principal and interest at the time and in the manner specified in the notes. These obligations constitute claims of the holders of the notes to receive money from the maker, and may be discharged in bankruptcy. At the same time there come into being, property rights by virtue of the execution of the mortgage securing the notes and by virtue of the statutes of the state wherein the property described in the mortgage is located. These constitute substantive rights in specific property and are protected by the Fifth Amendment. In law, the claims on the notes and the property rights under the mortgage and statutes are entirely separate and distinct. These separations exist not only in law, they are frequent in fact. Whenever the mortgagor conveys its property and the grantee does not assume the payment of the debt, a separation occurs. The debt remains the obligation of the mortgagor. The rights in the property created by the mortgage and statutes follow the property into the hands of the grantee.

If the District Court intended to find the value only of the notes, from the standpoint of their immediate collectibility, its finding of no value based on the market value of the property of the Debtor and the amount of the first mortgage thereon is entirely correct. When, as in this case, the principal property of the maker is subject to several liens, it follows that the claims based on the

notes secured by a junior lien may readily be valued by finding the value of the property and deducting therefrom the amount due on the notes secured by the prior lien.

When, however, the District Judge confirmed the plan on the basis that the notes of petitioners were of no value, he overlooked entirely the rights of petitioners under their mortgages and the Statutes of Illinois. Let us look at those rights.

Petitioners, just as the Bank in the *Radford* case, possess certain rights by virtue of the junior mortgages and the Illinois statutes, namely:

1. The right to retain their lien on the property described in the mortgages until the lien is paid or until the lien is terminated, as provided by law, by a public sale of the property.
2. The right to bid at such sale.
3. The right to redeem from such sale within one year from the date of the sale by paying to the purchaser the amount bid.

Let us consider for a moment the most important and most valuable right of petitioners, namely, the right of redemption. Under the laws of Illinois this right of redemption continues for twelve to fifteen months after the sale of the property. It constitutes an option to acquire the property during this period at the price bid at the sale with interest. What gives great value to this right is the fact that the redemption price is not the market value of the property, not the amount of the prior liens, but the amount bid at the sale which frequently is much less. This right is the exact equivalent of the right to receive all the increases in the value of the property over